PERSPECTIVES

November 2021

# 8 Planning Considerations for Your 2021 Audit

**Many hoped 2021 would return to business as usual. And while stability has returned for some, other organizations experienced disruptions — so it is understandable, then, that many are grappling with what "normal" is.**

COVID-19 continues to impact the business environment with mask mandates and other local restrictions hindering the recovery for some industries and regions. Staffing shortages and supply chain disruptions vex certain sectors of the economy as customers find empty shelves and reduced operating hours. Nor can we discount the impact of the 2020 election. With any new administration, change is expected and this one is no different - as the Biden administration is proposing significant changes for infrastructure and tax policy.

So, amid all this change, businesses must recalibrate and consider how these changes may have impacted their upcoming audit. Below, we offer key considerations when planning your audit for the year-end.

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## 1. THE NEW PRIVATE COMPANY AUDIT STANDARDS

The AICPA Auditing Standards Board's new suite of audit standards (whose effective date was delayed during 2020 for one year) will be effective for audits this calendar year-end. One of the most obvious changes coming from these standards is the new audit report language. Interestingly, the report now begins with the opinion and expands language to describe the responsibilities of the auditor and auditee more fully. If your company issues an annual report, consider if the new Other Information standard will require your auditor to report on that Other Information. Previously, the reporting was voluntary. Additionally, these standards require increased audit work regarding related-party transactions, including the necessity to establish the completeness of the transactions. Be aware that, at the planning stage, the new standards require additional communications between the auditor and client. As you begin planning your year-end audit, discuss with your audit team how these standards may affect your audit engagement.

## 2. INVENTORY CONSIDERATIONS

Supply chain disruptions have exacerbated shortages of inventory and raw materials and may create unusually low inventory balances at your financial reporting date. If your organization is impacted in this way, be aware of several related accounting issues:

1. Consider if the inventory that you do have on hand is sellable and the possibility of impairment has been evaluated.

2. Consider if your inventory costing methodology produces accurate results in this environment. Occasionally processes to price and relieve inventory balances contain assumptions about inventory turnover that may be quite different in this environment. If your methodology's assumptions employ historical data, the results may not be as accurate as you would expect. If you use Last-In-First-Out (LIFO), you may experience a LIFO decrement due to a depletion of your inventory levels. This reduction may 'eat into' a LIFO layer and thereby create income. For tax purposes, recording income on that decrement can only be overcome by an act of Congress and it remains to be seen if regulations are forthcoming to protect these LIFO layers.

### 3. TAX REFORM

Between general uncertainty and a highly charged political environment, there is no way to predict what, when, or if any tax changes will occur. However, it appears some degree of change is coming that will impact corporate tax provisions and tax planning. If history is any indicator, these changes may come very late in 2021, giving organizations limited time to react before the year-end reporting deadlines. Look to your DHG tax advisors to review your situation and discuss your options for addressing them.

### 4. LEASES

By now, everyone is aware that the new lease accounting standard (ASC 842, *Leases*) is nearing the end of its delay period for private companies. While the accounting entries for the transition are not recorded until next year (January 1, 2022, effective date for calendar year-end private companies), ensuring the accuracy of the accounting for leases under the legacy standard (ASC 840) is an important first step in implementation. Companies should spend extra time this year establishing that balances are accurate for transition to ASC 842. Locate lease documentation and ensure it is fully executed and up to date. If not, start the process to obtain the documentation. Additionally, it can take a substantial amount of time to identify embedded leases (lease contracts embedded into another service contract and not accounted for as a lease under ASC 840). You may want to devote resources to inspecting expense accounts that are at high risk for containing lease contracts prior to year-end or concurrent with this year's audit engagement.

### 5. ASSET IMPAIRMENTS AND GOING CONCERN

While asset impairments may feel like a 2020 issue, some companies may still be experiencing negative economic indicators. From an accounting perspective, asset impairments are complicated by the variety of accounting rules with different timing, methods and calculations. The choice is dependent on the type of asset and whether private company accounting rules have been elected. Impairments for long-lived assets (those being depreciated or amortized) are different from intangible assets with an indefinite life — and those are different than goodwill.

Understanding the unit of measure, the timing of the test and the calculation peculiarities are important for executing this exercise correctly. Be sure any possible impairments are identified early in the audit process and your documentation supporting your conclusion is robust.

Asset impairments and negative economic indicators raise the specter of Going Concern. Management is squarely responsible for this assessment (which will be specifically mentioned in the new auditor's report). As part of their analysis, management may need to project future cash flow. Imagine the difficulty you could encounter in creating these projections amid staffing shortages, reduced operating hours, inventory shortages, possible tax changes and pandemic unknowns. This may be the year that several cash flow scenarios need to be created using ranges of possible outcomes. Thorough documentation of any assumptions used in the analysis will be critical for the auditor's assessment of management's conclusions. Lastly, consider how expiring lines of credit or covenants breaches, both for the year-end reporting period and the going concern evaluation period, affect the analysis.

## 6. DEBT AND LEASE MODIFICATIONS

Over the past year, many companies and their lenders have renegotiated debt arrangements, including payment terms, due dates and covenants. Additionally, organizations have requested concessions on lease-related commitments. The accounting for such transactions can be complicated and require a thorough understanding of the rules and, in some cases, the pandemic-related "relief" rules provided by FASB. Review your situation accordingly.

## 7. GOVERNMENT STIMULUS

Since the influx of the pandemic, the federal government developed a myriad of assistance programs, all with varying degrees of accounting requirements. For some, a single audit requirement may have been triggered for the first time in company history. For others, how to recognize the offsetting accounting entry to the receipt of funds needs to be determined and updated through to the reporting date. If your organization has received assistance, you will have to consider that in your audit planning.

## 8. DIGITAL ASSETS

Has the use of digital payment streams been a conversation at your company? While it may not yet have affected your organization, companies are starting to encounter digital assets as ways to pay vendors, be paid by customers, or even to be maintained as an investment. If you are at or nearing this tipping point, it is time to involve your audit team to discuss the implication to your engagement.

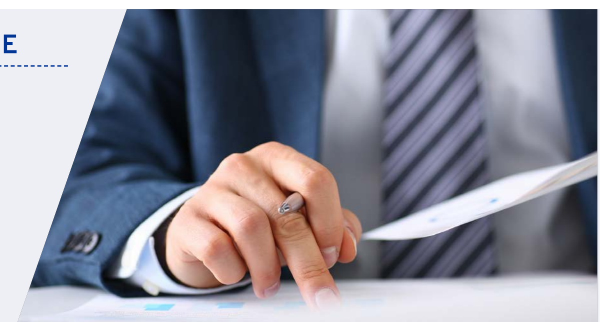
## HOW DHG CAN HELP

Whether or not any of these circumstances apply to your organization, your 2021 calendar year-end reporting deadline is drawing near. Talk with your external auditors or accountants early. Discuss what is new, what is complicated, where judgment is involved, and the assumptions used. These components will inform your plan for addressing any reporting issues.

Of course, in DHG you gain experienced assurance professionals who understand the nuances of your industry. We welcome the opportunity to put our comprehensive knowledge and insight to help your organization experience a smooth audit process.

### CONNECT TO MORE REPORTING-RELATED KNOWLEDGE SHARE

- 5 Impacts of the New Auditing Standards: SAS134-140
- What a Decrease in Inventory Means for Your LIFO Reserve
- 10 Lease Accounting Standard Questions, Answered
- COVID-19 and the Sequence of Asset Impairment Testing
- Consequences of Lease Modifications in a COVID World



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